

Frequently Asked Questions

Note: The following information is intended to be general in nature. It is *not* a statement of tax, securities or other law and should not be construed as either a statement of law or as constituting legal advice.

What Is An IRB?

An *Industrial Revenue Bond* (IRB) is the common name for tax-exempt economic development revenue bonds issued by the Washington Economic Development Finance Authority (WEDFA) to finance industrial development. Bond proceeds are loaned to a private concern which is then solely responsible for payment of interest and principal to the bondholders. There is no state or other governmental financial support, either direct or indirect for any WEDFA bonds.

Since WEDFA is a governmental agency of the state of Washington, the interest on its qualifying bonds are free from federal income tax which results in a lower rate for the borrower.

Why Use Industrial Revenue Bond Financing: Tax-exempt industrial revenue bonds have, in the past, had an all-in annual borrowing cost (including all letter of credit fees) of *several percent below prime!* For a qualifying project, *it's the cheapest money around!*

What Are the Negatives of IRB Financing: Due to the necessity of ensuring compliance with tax law requirements as well as the greater number of required participants associated with a bond issue versus a bank loan there are higher upfront costs than conventional financings. Although up to 2% of bond proceeds can be used for issuance costs, for smaller financings the borrowing company may have to pay some closing costs from other than bond sources. If the term of the bonds is relatively short, amortization of these costs may outweigh the interest-rate advantage.

Rapidly growing companies may find the \$10 million capital expenditure limitation (see below) and other Federal tax law limitations are too restrictive.

“Taxable Tail” Financing: Most projects will have cost elements - warehousing requirements, used machinery, planned expansion space, etc. - which will *not* qualify for tax-exempt financing. Financing of these costs through issuance of WEDFA's “**Taxable Tail**” bonds in conjunction with the tax-exempt portion can provide an efficient means of completing the total project financing in a single package with the savings associated with the blended rate. Also, prime-based borrowers will often find the interest rate on a “**Taxable Tail**” bond issue to be lower than conventional bank financing.

“**Taxable Tail**” financing will commonly be used *only* in conjunction with a companion tax-exempt financing. Very large (\$60 million +) projects may also want to explore straight taxable bond financing through WEDFA as an option. Since WEDFA is

legally a governmental entity, WEDFA's bonds are classified as "municipal bonds" and may therefore be purchased by a wider market than would be available for normal corporate debt. There is an approximate 10 basis point trading advantage to this approach. It must be emphasized, however, that this approach is only cost effective for large projects.

What Projects Are Eligible For IRB Financing?

The proposed financing must be for a *manufacturing or processing* project. Retail, non-manufacturing, real estate, commercial and service projects are *not* eligible.

Bond proceeds may be used to:

- o Acquire land,
- o Construct new facilities,
- o Purchase and rehabilitate existing facilities, and
- o Purchase *new* machinery.

If an existing facility is purchased, used equipment that is part of the facility may be included in the bond issue. An amount equal to 15% of bond proceeds must be spent for rehabilitation within two years, however.

Inventory, warehousing and working capital are *not* eligible uses for tax-exempt bond proceeds. WEDFA's "**Taxable Tail**" taxable bonds should be used in combination with the tax-exempt IRBs for these costs.

Project Size IRBs can be used for *up to \$10 million for a single industrial project*. However, there is also a restriction of \$10 million on the total capital expenditure by the company in the local jurisdiction in which the financed project is located. This \$10 million cap includes *all* expenditures which can be capitalized under generally accepted accounting principles, even if they are expensed rather than capitalized, and including those funded from sources other than bond proceeds. The period over which these capital expenditures are measured begins three years before and ends three years after the sale of the bonds.

The only exceptions to this capital expenditure limitation are replacements for property and casualty losses and project elements under a FASB 13 operating lease (**not** a capital

lease). While leasing of part of the project's equipment requirements may be an attractive option in a marginal situation, companies must be careful not to "let the financing tail wag the business dog".

While there is not a stated minimum project size for participation in the Program, projects less than \$1 – 1.25 million often find that the cost of the letter of credit and other issuance costs, relative to the size of the borrowing, makes other financing options more attractive.

Creditworthiness Each borrower stands upon their own creditworthiness; it is important to emphasize that *there is no governmental financial support, either direct or indirect, provided by WEDFA or any other governmental entity*. State securities laws require all industrial revenue bonds sold on the public markets to have credit enhancement, which will usually consist of a direct pay letter of credit for the full amount of principal plus 125 days' interest from an investment-grade rated bank.

As an alternate to issuance of a letter of credit to support the sale of the bonds on the national tax-exempt markets, the borrowing company may arrange a "private placement" of the bonds with an institutional investor. WEDFA staff can provide a listing of firms which have shown an interest in purchasing industrial revenue bonds in the past.

What Is An "Exempt Facility" And How Does It Differ From An IRB?

"Exempt facilities" is sort of a catch-all term for projects for which tax-exempt bonds may be issued, but which don't fit neatly in other categories. Some of the more important are solid waste disposal, sewage treatment, docks and wharves, local furnishing of electricity and mass commuting facilities. The most important difference between IRBs and "exempt facility" bonds is that the \$10 million capital expenditure limitation does not apply to "exempt facilities" projects. There are, however, other special rules applicable to certain of these categories. Please contact WEDFA for more information.

Since other aspects of "exempt facility" bond financing - creditworthiness requirements, financing team participants and the financing process are the same for "exempt facilities" as for IRBs, they are not separately discussed.

Who Are The Participants In The Financing Process?

Key participants on the financing team include:

- o Borrowing company,
- o Letter of credit bank or institutional investor purchasing the bonds,
- o WEDFA, as issuing authority,
- o Bond counsel,
- o Underwriter (for public sales and some private placements),
- o Trustee (if applicable).

The roles of each of the participants are:

Washington Economic Development Finance Authority (WEDFA)

WEDFA acts as the *issuing authority* for the bond issue. WEDFA approves the Initial Action Resolution, which allows the project being financed to be started prior to bond issuance, as well as the bond resolution and other documents required for bond sale. WEDFA will also perform certain required actions, such as scheduling and conducting the required public hearing, obtaining planning jurisdiction approval and the required allocation from the state's volume cap.

Bond Counsel Bond counsel is a legal firm with special expertise in municipal bond and federal tax law. Bond counsel provides the legal opinion that interest on the bonds is tax-exempt under federal law, that the transaction is legally sound, and that the bonds are valid and binding obligations. Bond counsel also prepares much of the bond documentation.

Bond counsel is selected by the borrowing company, subject to WEDFA's approval. WEDFA staff would be happy to provide a listing of eligible firms.

Underwriter The primary role of the underwriter is to purchase the IRBs from WEDFA, and to resell them on the national bond market. In order to qualify for exemption from SEC Rule 15c2-12 (see "What Else Do I Need To Know" below), bonds sold through an underwriter on the national bond markets will usually have a short-term variable interest rate.

If the bonds are being purchased by institutional investors, the services of an underwriter would not usually be required.

Trustee The trustee is a financial institution which provides fiduciary and accounting services for the bondholders, and is charged with generally representing the bondholders' interest. The trustee will handle all funds associated with the bond sale, receiving all the monies generated from the bond sale and passing them on to the local bank for disbursement to the borrowing company. The trustee receives all principal and interest payments from borrowing companies and makes payment to the bondholders on predetermined dates.

If an institutional investor purchases the bonds for their own portfolio, they may act as their own trustee.

Letter of Credit Bank (LOC) The LOC bank is one whose long-term unsecured credit is *rated investment-grade* by either Moody's or Standard & Poor's. The LOC would normally be either the borrowing company's regular primary commercial bank, or have a correspondent relationship with the borrowing company's regular primary commercial bank. Through its letter of credit to the individual borrowing company, the LOC bank provides the credit enhancement, and bears the credit risk of the borrowing company. The LOC bank also acts as loan servicer after the bond proceeds have been disbursed.

If the bonds are placed with an institutional investor, a letter of credit may or may not be required.

Institutional Investor As an alternative to a letter of credit and sale through an underwriter on the national bond markets is a private placement with an institutional investor as a portfolio investment. This "institutional investor" must be an Accredited Investor(s) as such term is defined in 17 CFR 230.501(a).

An institutional investor will apply the same credit standards a bank would in considering issuance of a letter of credit. Since the number of required participants is fewer than for a public offering, issuance costs for a private placement will generally be less. Also, because private placements are not subject to the secondary market disclosure requirements of Rule 15c2-12, fixed rates may be available. The interest rates will generally be higher than can be achieved by a public sale, however.

What Does All This Cost?

The following are the cost elements which will typically occur in an IRB financing. Each financing is an individual transaction, and the dollar amounts may vary considerably, depending on the details of each individual transaction.

Issuer Fees WEDFA charges a \$750 non-refundable application fee and an issuance fee equal to 3/10s of 1%, or \$9,500, which ever is higher, of the principal amount of the bonds. There is no annual fee.

Bond Counsel This is usually an hourly plus expense quotation. Depending on the complexity, this will usually vary between approximately \$7,500 and \$20,000, but may be higher.

Underwriting/Placement Fee Usually about 1% or less of the principal amount depending on whether it is fixed or variable rate and publicly sold or privately placed.

Bond Cap Allocation Fee 0.000277 times the tax-exempt bond par or \$500, whichever is greater.

Legal Notice Fees These are paid by WEDFA from application fee monies.

Printing Costs If the bonds are sold publicly, there will be a printing charge for the Official Statement. While this varies, it should be approximately \$3,000 - \$5,000.

Trustee Fee If the bonds are sold publicly, a trustee fee of approximately ¼ % will be charged at closing. A privately placed issue, depending on the details of the transaction, may not require a trustee.

Remarketing Agent Fee If the bonds are publicly sold as variable rate bonds, a Remarketing Agent will be required. The usual closing fee should not exceed 1/10 - 1/8 of 1% of the issuance amount.

In addition to the costs listed, the borrowing company will incur the following costs, which should be taken into consideration:

- o *LOC costs and fees(if applicable):* These will normally consist of a letter of credit issuance as well as the bank's legal and out-of-pocket costs. As these are negotiated directly between the borrowing company and the LOC, they will depend upon the company's overall relationship

with the LOC bank, as well as the bank's policies in this regard. In the past, LOC issuance fees of 1% have not been an unusual level.

- o *Borrowing company internal costs:* As in any financing, decisions and due diligence requirements specific to the individual borrowing company will require management time and there will be an opportunity cost associated with this.
- o *Legal and Accounting:* As in any financing the company will require these professional services from its regular legal advisors and accountants.

Annual Costs WEDFA does not charge an annual fee. The borrowing company will be responsible for the following annual costs:

- o *Borrowing company internal and other direct costs.*
- o *Annual LOC fee* (negotiated directly between the LOC bank and the borrowing company).
- o *Annual bond expenses*, which would include:
 - * annual Trustee fee and expenses (if applicable),
 - * remarketing and paying agent fee (as applicable),
 - * miscellaneous costs.

How Long Will It Take To Get The Money?

The length of time the financing process will take is dependent on the Project's progress. WEDFA does most of its bond-related work by special meeting via telephone conference call. These meetings are scheduled on an as-needed basis; there is no need to conform to any preset WEDFA meeting schedule.

Historically, the two factors which have determined the pace of the financing process have been the LOC bank/placement source due diligence underwriting process and any unusual permitting requirements (e.g., Shoreline permit). The shortest time between

application to WEDFA and bond closing has been seventeen days; the longest 2 ¼ years. WEDFA can move as fast as the project can

What Are The Steps in The Process?

Following is an outline of the steps that a borrowing company will go through in the issuance process for an industrial revenue bond financing. Although these are listed as discrete steps, in actual practice many of them will occur simultaneously. The time period between the initial contact between WEDFA and the potential borrower and actual bond sale will vary depending upon the status of the project planning as well as other factors. While it could take as little as two months, this time frame would probably be longer, depending upon the progress of the project being financed.

1. *Preliminary Discussion and Application* Representatives of the company seeking funding should contact WEDFA to discuss details of the proposed project. Contact with WEDFA staff can be made through the company's local economic development organization, banker, bond counsel, or directly, as appropriate. If the project appears to meet eligibility requirements, the company should then submit an application to WEDFA with the application fee. WEDFA will then schedule a special meeting to consider adoption of an initial Action Resolution.
2. *Credit Enhancement/Institutional Investor* Concurrently, the company should begin negotiations for either the issuance of a letter of credit from an investment grade bank in support of the bond issue or the purchase of the bonds by a qualified institutional investor. A commitment letter from the LOC bank/institutional investor will be required before the issuance process can be started.
3. *Initial Action Resolution* At the special meeting of the WEDFA board following submission of the application to the Authority by the company, the board will consider passage of an Initial Action Resolution. This is a very important step. It does not commit the company to anything; however, *all eligible costs* incurred after a date 60 days prior to the Initial Action Resolution's approval may be funded through a tax-exempt bond issue. Costs incurred before that date cannot be so recouped.
4. *"All Hands" Meeting* As soon as practicable after passage of the Initial Action Resolution and receipt of the LOC/institutional investor commitment letter either WEDFA or the underwriter will schedule an "all hands" conference call to discuss what needs to be done by each of the participants and set a timetable.

5. *Documentation* Bond counsel and underwriter/institutional investor's counsel will start working on the bond documents - the loan agreement, trust indenture, bond purchase agreement and others - and circulating them to the participants for comments.
6. *Bond Cap Allocation and Local Approval* WEDFA will submit an application for required bond cap and request an approving resolution from the local planning jurisdiction. WEDFA will also arrange for publication of the legal notices for the required public hearing.
7. *Bond Resolution and Closing* At the WEDFA board meeting scheduled in the financing timetable, the board will conduct the required public ("TEFRA") hearing. Following that hearing, the board will consider the Bond Resolution approving the sale of the bonds. Closing occurs as soon after the bond sale as practicable - usually within two weeks. At closing, the funds for the loan to the borrowing company are obtained and placed on deposit with the Trustee (if applicable) for further disbursement.

What Else Do I Need To Know That I Haven't Asked?

Incurrence of Costs

The first step in the bond issuance process is the issuance of an Initial Action Resolution (frequently known as an "Inducement Resolution") in support of the project by WEDFA. Issuance of this Resolution *does not commit* either the company to proceed further with the project or WEDFA to ultimately issue the bonds. It's basically a date stamp. All eligible costs which are incurred *after a date 60 days prior to the issuance of an Initial Action Resolution* can subsequently be recouped from bond issuance. Costs incurred before that date cannot. Because of this "date stamp" effect, it's important to have the Initial Action Resolution issued as early in the process as possible.

Bond Cap Allocation

Federal tax law only permits a limited dollar volume of certain types of tax-exempt bonds to be issued in the state in a given year. This dollar amount of "permission" for the state is generally referred to as bond cap. Please note this is only an authorization to issue bonds on a tax-exempt basis; there are no actual dollars involved.

In addition to IRBs and “exempt facilities” bonds issued by WEDFA, bonds issued by the state and local housing authorities, student loan bonds and certain bonds issued by the mid-Columbia public utility districts must get an allocation of the state’s bond cap. WEDFA has always been able to get a full allocation of its IRB bond cap requests.

Required Disclosures Amendments to Rule 15c2-12 of the federal Securities Exchange Act imposed new disclosure requirements on issuers of municipal debt, including industrial revenue bonds. These amendments require the continuing annual disclosure of key financial and operating data and timely disclosure of certain material events when they occur.

WEDFA recognizes that most of its clients will not wish to make disclosures of this nature. There *are* certain exemptions from these requirements, however, and WEDFA bond issues are usually structured to take advantage of these exemptions.

Other Types of Financings Although WEDFA’s focus is on IRBs and “exempt facility” projects, the Authority is not a “one trick pony”. WEDFA has done other types of bond finance in the past and expects to do more in the future.

Provided that a project is within our statutory authority, is legally and financially sound and provides a public benefit to the state, WEDFA is open to consideration of other types of financing. WEDFA staff can provide further information.